FINANCIAL INSTITUTIONS COMMITTEE MEETING
Business Law Section, State Bar of California

Meeting of August 8, 2006

Committee Members Present: John Hancock, Chair; Meg Troughton, Vice Chair; Rosie Oda, Secretary; Michael Abraham; Bruce Belton; Leland Chan; Laura Dorman; Andrew Druch; Jim Dyer; Bart Dzivi; Rob Hale; Teryl Murabayashi; Allan Ono; Russ Schrader; Brad Seiling; Bob Stumpf; and Keith Ungles; and Richard Zahm.

Advisory Members and Others Present: Sally Brown; Gino Chilleri; Jonathan Jaffee; Ted Kitada; Elaine Lindenmeyer; Michael Occhiolini; Mike Ouimette; Jim Rockett; Ken Scott; Steven Takizawa; and Gerry Tsai.

Committee Members Absent: Mark Gillett; Jay Gould; Linda Iannone; Randy Kennon; Ken Krown; Rosemary Lemmis; and Todd Okun.

Call to Order: Our Chair John Hancock of World Savings called the meeting to order at 9:35 A.M.

Welcome to Members and Advisory Members: John welcomed the Committee Members and the Advisory Members and asked each person to identify themselves and where they worked. Rosie Oda of Pillsbury introduced Mike Ouimette, a senior associate at Pillsbury who has worked on banking and corporate matters for five years, who joins us as a Constituent Representative.

1. Approval of July 11, 2006 Minutes: The Committee approved the minutes of the July 11, 2006 meeting subject to a correction to be made in the spelling of Elaine Lindenmeyer's last name, who is with Kirkpatrick & Lockhart. Rosie then proposed a change to the minutes of our November 8, 2005, by deleting the remainder of the third sentence of item 3, paragraph two, to end the sentence with the phrase "elder abuse training," at the request of EFPN. The Committee approved the change in the November 8, 2005 minutes.

2. Status Report on the FIC presentation on Credit Union Conversions: Rosie reported that with the help of Assistant General Counsel Gerry Tsai, Federal Reserve Bank of San Francisco, we have prepared an announcement of and agenda for the Committee's presentation on the subject of Credit Union Conversions to be held at the FRB-SF on September 8, 2006. Our Chair reported that he had emailed the announcement and agenda to members of the Committee before today's meeting. Leland Chan of the California Bankers Association has arranged for Barrie Graham, a Director of the CBA to be on the panel, and Bob Arnould of the California Credit Union League will briefly explain the differences between banks and credit unions. Leland and Bob will distribute the announcement to their respective association members. Our featured speaker will be Professor Jim Wilcox of the Haas School of Business, who has just published a book on this subject. And we have a special guest from Washington, D.C.,

John Bowman, Chief Counsel, Office of Thrift Supervision, on the panel as well. Because of security concerns at the FRB-SF, RSVPs will be necessary, and we expect a capacity crowd. MCLE credit is available.

3. RESPA: Jonathan Jaffee of Kirkpatrick & Lockhart reported on recent enforcement actions under the Real Estate Settlements Procedure Act taken by the Department of Housing and Urban Development under Section 8. Jonathan alerted us to the sudden increase in enforcement actions concerning the proscription against receiving any "thing of value" in exchange for settlement services. In 32 years, there have been 30 major settlements, but in contrast in the last year, HUD has taken 17 enforcement actions. According to Jonathan, no segment of settlement service has been left untouched. One particular settlement against a title insurer was for $1.6 million. Some of these actions could lead to the conclusion that there is no such thing as a valid reinsurance deal in the private mortgage insurance setting now that HUD has noted that historical losses are rare in the case of captive reinsurers in that area. On the other hand, he points out that consumers don't pay a penny more for this service, but these actions do call into question the underlying premiums. As a result the stock price of title reinsurers has fallen.

4. *Kearny v. Salomon Smith Barney*: Our Chair John Hancock of World Savings reported on this California Supreme Court case filed last month (No. S124739). John began by describing the case as an exegesis on conflicts of law. The case is of interest to banks with telemarketing operations because Salomon, which is based in Georgia, was recording telephone conversations with California clients without the clients' knowledge or consent. California is one of 11 states requiring two-party consent. California law requires the consent of **all** parties to the conversation whereas Georgia does not prohibit recording when made with the consent of **one** party to the conversation. The California Penal Code prohibits secretive recording, and Georgia also shares that intent even though recording a conversation without consent of all other parties to the conversation is not unlawful in Georgia. The court applied the governmental interest analysis to find a conflict of laws. It concluded that California had a significant interest in protecting the privacy of phone conversations of California residents, and Georgia's interest in protecting the part of the conversations occurring in its state would not be impaired. No monetary penalties were assessed in view of Georgia's expectation that its citizens would not be subject to liability for monetary damages for past actions but not future actions in California for recording conversations in a way that is legal in Georgia.

John reminded bankers that, as a result of this case, if they are calling into California from another state, they need to make an announcement that the call is being recorded. Elaine Lindenmeyer of Kirkpatrick asked about using a "beep" tone, and John replied that he did not believe that would help and recommended an announcement instead. Bob Stumpf of Sheppard Mullin praised the California Supreme Court for making the right decision, being very practical and doing a great job.

5. Federal Trade Commission Advisory Letter on "Do Not Call" Requirements: Our Chair John Hancock reported on the FTC advisory letter, issued under its Telemarketing Sales Rule, dated July 19, 2006, concerning the exemption for an

established business relationship ("EBR"). He noted that the FTC generally follows the Federal Communication Commission rulings since this is primarily the FCC's area of regulation. The letter addresses whether the exemption applies to a lender that initiates a telephone call to a consumer based on contact information the lender obtains from an internet based lead generator. The question is whether a lender must screen against the "Do Not Call" list (John noted that half of the United States is on that list). The FTC agreed to take no action even though the lender does not generally have its own EBR with the consumer. The consumer expects to receive calls as a result of her visit to the website and divulging her phone number, as long as the lead generator makes adequate disclosures as described in the advisory letter. John noted that substantial penalties of $1,000 per violation are possible, and a private right of action is available for failure to comply, if more two unsolicited telemarketing phone calls are made within a twelve month period. Ted Kitada of Wells asked if the rule applies to text messages, and John said this issue has come up as well as spam text messages, and Jim Rockett of Bingham added that there have been some class action suits on the subject.

6. *SPGGC v. Ayotte*: Ted Kitada reported on this case, in the District Court in New Hampshire against the State Attorney General, which addressed the sale of prepaid gift cards. Ted said the case was welcome news to the banking industry. New Hampshire has a Consumer Protection Act which prohibits gift certificates with expiration dates, dormancy fees, or other fees. SPGGC operates malls and issues gift cards as agent for U.S. Bank (a national bank) at the malls and for MetaBank (a federal savings bank) over the internet. These gift cards have expiration dates and various fees. The court issued a declaratory judgment that the state law was preempted by federal law even though the seller of the gift cards was not itself a bank or thrift. Russ Schrader of VISA commented that the case could be appealed by September 1st, and that the OCC might file an amicus. His comment was followed by some discussion of banks' use of agents and whether preemption should still apply. Ted mentioned that the court was very straightforward that the state could not enforce indirectly what it cannot enforce directly.

7. *Frazier Nuts, Inc. v. American Ag. Credit*: Bob Stumpf reported on the Fifth District's August 2, 2006 published opinion in *Frazier Nuts, Inc. v. American Ag. Credit* (No. F047759). This opinion holds that the so-called "producer's lien" that sections 55631 et seq. of the Food & Agriculture Code create on the products farm producers deliver to processors also extends to the proceeds the processors receives in selling the products to third parties -- and has priority over the perfected security interest of the processor's lender. The opinion raises a question of first impression under California state law, and the Fifth District's opinion is directly contrary to the decision of the Bankruptcy Court in *In re Sargent Walnut Ranches, Inc.* (Bankr. E.D. Cal. 1998) 219 B.R. 880. Next stop: California Supreme Court?

8. FDIC Guidance on Outsourcing: Jim Rockett of Bingham McCutcheon (substituting for Maureen Young) reported on implementation of this FDIC guidance based on a recent experience of his clients. Some of them were using a third party processor which experienced an outage on July 26th or 27th. The outage caused a failure of core processing for 26 banks whose work was not processed for three days. Thus,

payrolls were not paid, ATM cards were not honored, and checks bounced. Jim reported that the contract provisions were light on protecting his clients. But what really surprised him was that the bank regulators appeared disengaged. Jim believes that the regulators need to get more involved, particularly since, unlike larger banks which can dictate their own contractual terms, third party processors tend to treat the smaller banks on a take it or leave it basis. All indemnities therefore run in favor of the processor, which Jim pointed out may raise safety and soundness issues. According to Jim, the FDIC had certified their programs even though the recovery program would take at least two days to implement, which means that by that time, damages would have already occurred. There are few alternatives for small banks; business interruption insurance is very expensive, and in any case, insurers would probably view such an occurrence as a breach of the policy.

9. Federal Legislative Report: Bart commented that the federal legislative process was winding down. This Congress has set the record for sitting the fewest days in the last century. The House has only 15 days left in the year. Thus, all legislative proposals submitted over the last two years are essentially dead, with the possible exception of the Regulatory Relief bill. The Senate version of that bill, unfortunately, includes provisions that will make directors personally accountable for raising bank capital in an enforcement action.

10. New Members: John asked that we vote on two new members. Elaine Lindenmeyer left the room so we could vote, and she was unanimously accepted for the coming year. We have several more spots that need to be filled. We also voted unanimously to accept Shirley Thompson of Wells.

11. Miscellaneous: Leland Chan of the CBA reported that San Francisco has issued a Health Care Security Ordinance and asked our members to review a summary that he will send under separate cover and let him know how it will affect our banks or clients. The ordinance could be preempted by ERISA. Meg Troughton of BofA pointed out the possibility that the ordinance could be preempted by the OCC.

12. Adjournment: The meeting was adjourned at 11:00 a.m.